State of the property market in quarter 2 of 2020

Rode's latest survey results confirm – if confirmation was necessary – that the SA property market is under serious pressure. The economy has now been in recession since the third quarter of 2019, and the impact of Covid-19 will accelerate the slide. The emergency budget delivered in June points to a worsening fiscal crisis, which could drag South Africa (or the bakkie on the front page) over the cliff if drastic measures are not implemented. The severe economic slowdown has implications for the valuation of property and we deal with this in our special article at the beginning of report.

The second-quarter surveys were conducted in May 2020 when transaction volumes were very limited due the lockdown, which forced estate agencies to temporarily close or work from home, preventing the physical inspection of properties. One would imagine that convincing a buyer to purchase or a tenant to rent a property without physically seeing it would be difficult, even if you had the best technology at your disposal. In fact, out of Rode's total survey respondents, 56% said the first-quarter data were still applicable due to lack of new transactions. Almost all other respondents provided data indicative of a weaker market. We expect the real impact of the coronavirus crisis will only be seen in coming quarters as transaction volumes increase. Leases that come up for renewal will see sharp rental reversions as most landlords aim to keep tenants as the risk of finding good new tenants in this market is high.

A vital point to remember is that the property market was already oversupplied before Covid-19 emerged in South Africa in March. This implies that the pandemic will prolong the oversupply situation, with a sustained upturn now several years away.

A summary of the main findings by property type follows.

Quantitative overview of the property market

Table 1 on the page 3 provides a snapshot of how the property market has performed over the past four quarters by comparing the latest information (quarter 2020:2) with data collected a year earlier.

Office market

Nationally, nominal market rentals for grade-A office space in the second quarter of 2020 increased by only 1% compared to a year ago – lower than the 4% year-on-year growth recorded in the first quarter of 2020, according to Rode's office market survey. This has been the weakest year-on-year change in rentals since 2013. Rentals decreased by 1% compared to the first quarter of 2020. This implies that rentals moved even deeper into negative territory when measured in *real* terms; that is, after accounting for building-cost inflation (BER BCI) of around 8%.

Over the past year, grade-A rentals grew by about 4% in both Cape Town and Durban, while growing by 1% in Johannesburg. Rentals declined by 3% in Pretoria. Almost all cities recorded lower rentals compared to the first quarter, but not by more than 2%.

Due to its significant oversupply, the office market was in deep trouble even before Covid-19 came along in March this year. Nationally, decentralized vacancy rates for grade-A and B-offices combined averaged 11,1% in the first quarter of 2020, up from 10,6% in the fourth quarter of 2019 and the worst rate since early 2004. We expect vacancy rates to increase sharply over the rest of 2020 and into 2021 as more companies close. Companies might also reduce their required space as more employees work from home on a permanent basis, leading to a prolonged oversupplied market. However, this impact will be offset somewhat by more space per employee required to adhere to social distancing guidelines.

Positive aspects for the market are the big slowdown in building activity and the fact that international and domestic REITs have reported a high percentage of rental collections in April and May, probably as most companies that were forced to close their offices could work from home and still obtain some form of income.

Industrial market

Our survey results show that the industrial market, like other property sectors, is also feeling the impact of the very weak economy, which has been dragged down further by Covid-19 since March 2020. Nominal industrial market rental growth slowed to 1% year on year in the second quarter from 2% in the first quarter, with vacancies remaining higher than in 2019. Rentals were virtually unchanged compared to first-quarter levels. We believe this is reflective of the very thin market, with few transactions taking place during the lockdown.

Nominal rental growth for prime industrial space of 500 m² was the fastest in Cape Town at about 4% compared to a year ago. Rental levels stayed roughly the same in the East Rand but fell by 3% in the Central Witwatersrand. This implies that all regional rentals increased at a slower rate than building-cost inflation.

A positive aspect for the market is that domestic REITs exposed to industrial property have reported a high percentage of rental collections in April and May, especially those linked to logistics where rental collections were in the high nineties. This is because essential retailers have stayed open during the entire lockdown and had no excuse to plead poverty.

Residential market

The housing market is under increasing pressure, with national house price growth continuing to weaken. The latest data from FNB show that nominal house price growth slowed to 1,9% year on year in April 2020, down from 2,5% in March, and the lowest since end 2009. This implies that prices have continued to decline in *real* terms after having taken out inflation. *Please note that the April data do not fully reflect the impact of the lockdown.*

The housing market is still a buyers' market due to the oversupply, most significantly at the high end of the market where sales volumes have declined drastically. The very-low end of the market remains the best positioned as demand still exceeds supply (as far as we know!).

A boost for the residential property market has been the sharp cut in short-term interest rates to the lowest in 50 years. However, the interest rate cuts won't be enough to cancel out the deleterious effect of the recession – a recession that could last a long time.

Nationally, flat vacancy rates averaged 7% in the second quarter of 2020, up from 5,5% in the second quarter of 2019. High and rising flat vacancy rates have led to slower rental growth, which in the first quarter of 2020 averaged 3,2% on a year earlier – the slowest since at least 2009. This implies that rentals are declining in real terms. Vacancy rates will rise further in the short term as the sharp contraction in the economy puts significant financial pressure on many tenants, leading to more evictions as we move to lockdown level 2 and lower (evictions are not allowed under lockdown levels 5 to 3).

The stark reality for owners of residential property will be to choose between lower rentals or no rentals. ■

Table 1
Rental performance as at quarter 2020:2
% change from four quarters ago (on smoothed data)

	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	0,6	-7,3
Rosebank	1,9	-6,1
Randburg Ferndale	-2,4	-10,1
Centurion	0,1	-7,8
Menlyn	-5,6	-13,1
Berea (Durban)	-8,0	-15,3
La Lucia/Umhlanga Ridge	4,7	-3,6
Claremont Upper	7,2	-1,3
Tyger Valley	5,3	-3,0
Century City	6,8	-1,6
Prime industrial rentals (500-m² units)		
Central Witwatersrand	-2,6	-10,2
East Rand	0,4	-7,5
Durban	3,2	-5,0
Cape Peninsula	3,5	-4,6

*Nominal values deflated by BER Building Cost Index (2016 = 100)